

Ethnic, Skill, Qualification Diversity of Board of Commissioners and Stock Performance

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ABSTRACT

The goal of this study is to examine the effect of ethnic, skill, and qualification diversity of the board of commissioners on stock performance in emerging markets. This study employs 266 companies listed on IDX (Indonesia Stock Exchange) during 2011-2017 periods. The result shows that ethnic, skill, and qualification diversity of the board of commissioners do not have a positive impact on stock performance among Indonesian companies. However, quality audit and company age (CA) have negative and significant impact on stock performance.

Keywords: *Stock performance, ethnic, skill, qualification, board of commissioners*

1. INTRODUCTION

Competition in business nowadays have arised around the world. This impacts the composition of board of commissioners in the Continental European system. Company should choose the board of commissioners that represents the interest of owners. The diverse board of commissioners is believed as one among the strategies that can be used by company to influence stock performance.

Some researchers state that the higher level of diverse board produces better monitoring and higher quality of decision-making (Gray and Nowland, 2015), brings greater pool of abilities, skills, knowledge, priorities, and perspective for problem solving (Harjoto, Laksmana, and Yang, 2019), and increases company performance (Van der Walt, Ingley, Shergill, and Townsend, 2006). Thus, greater diversity of board of commissioners creates diverse skill, knowledge, and experience that influences board of commissioners in monitoring and controlling board of directors.

Most prior researches that investigated stock performance focused on independent directors (Du, Li, Lin, and Wang, 2018) size, quality, and independence of board (Azzoz and Khamees, 2016), dividend (Ahmad, Bakar, Faziharudean, and Zaki, 2014; Anwar, Singh, and Jain, 2015), and ownership structure (Sukcharoensin and Sukcharoensin, 2018). The lack of attention has been paid to explain the impact of ethnic, skill, and qualification diversity of board of commissioners on stock performance among the countries that adopt Continental European system. Thus, this paper is the first to the authors' knowledge to investigate the impact of ethnic, skill and qualification diversity of board of commissioners on stock performance. The rest of this study is structured as follows. Section two provides relevant literature and hypothesis development. It continues to discuss the research method. Result and discussion is presented in section four. Final section explains the conclusion and recommendation from this study.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Based on the agency perspective, board of commissioners is a central for internal corporate governance. It has primary role in monitoring board of directors and lowering the conflict of interest between board of directors and shareholders (Jensen and Meckling, 1976). According to Shan and McIver (2011), board of commissioners is less effective in lowering the agency cost. It is hoped that the present of diverse board of commissioners could reduce the agency cost and enhance stock performance.

2.1 Ethnic Diversity of Board of Commissioners

Indonesia has more than 300 ethnics. The biggest one is Java ethnic. It is around 41% of Indonesia's population coming from Java ethnic. The other ethnics are Chinese. It consists of minority ethnic, but they dominate Indonesian business. According to Lam and MacGregor (2018), Chinese has good quality in culture in term of collectivism, masculinity, long-term orientation, and power distance. Meanwhile, Javanese is likely avoiding conflict, cool-tempered, soft, and hard-working (Retsikas, 2007). Thus, the ethnic diversity of board of commissioners creates high creativity and innovation (Erhardt, Werbel, and Shrader, 2003) and increase productivity through the effectiveness of board action (Ujunwa, Okoyeuzu, and Nwakoby, 2012).

Prior literatures that investigated the effect of ethnic diversity and performance showed mix finding (e.g., Abdul, Marzuk, Jaafar, and Masron, 2018; Anifowose, Abdul Rashid, and Annuar, 2017; Fernandez and Thams, 2018; Hassan and Marimuthu, 2018). Anifowose et al. (2017) found that ethnic diversity has negative effect on intellectual capital disclosure. Abdul et al. (2018) found that negative association between ethnic and total directors'

remuneration. Using the Generalised Estimating Equations (GEE), Fernandez and Thams (2018) observed ethnic diversity on board members. They found that ethnic diversity of board increases effective stakeholder management.

H1: Ethnic diversity of board of commissioners influences stock performance.

2.2 Skill Diversity of Board of Commissioners

Skill diversity means various experiences of board members such as business, accountant, lawyer, engineering and others. Skill diversity of board of commissioners will help them control and monitor the board of directors better, because skill diversity may create high quality decision (Sarwar, Xiao, Husnain, and Naheed, 2018), better advisory and monitoring through critical thinking of board (Gray and Nowland, 2015), and increase their confidence in selecting good strategy to maximize the shareholders' wealth (Matemilola, Bany-Ariffin, and Azman-Saini, 2013).

Sarwar et al. (2018) examined the skills of board of directors in emerging countries such as Pakistan and China. They found that increasing the skills of board of directors will lead to the enhancement of shareholders interest as proxied by dividend in Pakistan, while Chinese companies do not use dividend as control mechanism. Gray and Nowland (2015) found that company should limit the skill diversity of directors only on lawyers bankers, consultants, accountants, and outside CEO expertise in order to enhance shareholders value. Ooi, Hooy, and Som (2017) found that skill diversity has negative and significant influence on company performance.

H2: Skill diversity of board of commissioners influences stock performance.

2.3 Qualification Diversity of Board of Commissioners

Qualification diversity means various education backgrounds of board of commissioner members. Chiang and He (2010) believed that better knowledge of directors come from their educational degrees. Various education backgrounds of board members create better in choosing strategy (Kuo, Wang, and Yeh, 2017) and produce diverse perspective among board members in enhancing shareholders' interests (Harjoto et al., 2019). However, Kagzi and Guha (2018) noted that higher level of qualification diversity creates insecurity among board members and produces conflict among majority and minority groups.

Kuo, Wang, and Yeh (2018) investigated the level of directors' education and R&D investment among 437 companies listed in Taiwan. They found that directors' with higher level of education tends to invest more in R&D. While, Kagzi and Guha (2018) found a negative relationship between education diversity and company performance. Using 879 US companies, Harjoto, Laksmana,

and Yang (2018) found that qualification diversity of board of commissioners has positive and significant impact on corporate social performance. Ooi et al. (2017) found that qualification diversity of board has no impact on company performance.

H3: Qualification diversity of board of commissioners influences stock performance.

3. RESEARCH METHOD

This study conducts panel data analysis among 226 companies listed on Indonesia stock exchange (IDX) during 2011-2017 period. This study uses stock return to measure stock performance. According to Azzoz and Khamees (2016), stock prices represents the real value of company due to it cannot be manipulated by directors. Based on Carpenter, Sanders, and Gregersen (2001), stock return is measured by the formula below:

$$\text{Stock Returns} = \frac{(\text{Price}_{t+1} + \text{Dividend}_t - \text{Price}_{t-1})}{\text{Price}_{t-1}} \quad (1)$$

The independent variables in this paper consist of ethnic, skill, and qualification diversity of board of commissioners. Following existing studies (e.g., Díaz-Fernández, González-Rodríguez, and Pawlak, 2014; Kagzi and Guha, 2018; Wellalage, Locke, and Scrimgeour, 2012), all independent variables (ethnic, skill and qualification diversity) are measured by Blau index (Blau, 1977).

$$\text{Blau index} = 1 - \sum_{i=1}^n P_i^2 \quad (2)$$

The index value of ethnic of board of commissioners is ranged from 0 to 0.67. It is categorized into three groups, that are Chinese, Javanese, and others. Following prior study of Ooi et al. (2017), skill diversity is categorized into law, academic, public service, business, and others. The index value of skill diversity ranges from 0 to 0.87. This study uses four categories of qualification diversity, that are doctorate degree, master degree, bachelor degree, and high-school degree (Kuo et al., 2017). Quality audit is coded 1 if the auditor comes from The Big Four, and 0 if otherwise (Wu, 2012). Company age is the number of years since the corporation was established (Muller-Kahle, Wang, and Wu, 2014). The empirical model of this study is as follow:

$$SP_{it} = \alpha + \beta_1 EBOC_{it} + \beta_2 SBOC_{it} + \beta_3 QBOC_{it} + \beta_4 QA_{it} + \beta_5 CA_{it} + e \quad (3)$$

SP = Stock Performance
 EBOC = Ethnic of Board of Commissioners
 SBOC = Skill of Board of Commissioners
 QBOC = Qualification of Board of Commissioners
 QA = Quality Audit
 CA = Company Age

4. RESULT AND DISCUSSION

Table 1 shows the summary statistics from 266 companies. The average stock performance (SP) is 0.17. The mean (median) of ethnic of board of commissioners (EBOC) is 0.33 (0.44). The mean value of skill of board of commissioners (SBOC) is 0.32 and 0.43 for qualification of board of commissioners (QBOC). On average, quality audit (QA) included in this study is 0.37. The value of company age can be ranged from the lowest of 9.12 to the highest of 122 years, with mean value 34.46 years.

Table 1. Descriptive Statistics

	Min	Max	Median	Mean	Std. Deviasi
SP	-0.87	25.78	0.09	0.17	1.19
EBOC	0.00	0.67	0.44	0.33	0.25
SBOC	0.00	0.87	0.38	0.32	0.27
QBOC	0.00	0.75	0.48	0.43	0.25
QA	0.00	1.00	0.00	0.37	0.39
CA	9.12	122.00	34.00	34.46	14.30

Notes: SP = Stock Performance (ratio), EBOC = Ethnic of Board of Commissioners (index), SBOC = Skill of Board of Commissioners (index), QBOC = Qualification of Board of Commissioners (index), QA = Quality Audit (dummy), CA = Company Age (year).

The empirical findings are represented in Table 2. EBOC has insignificant relationship with stock performance. This finding is inconsistent with prior work of (Fernandez and Thams, 2018). They found that ethnic diversity of board creates more effective stakeholder management. The other independent variable is SBOC. SBOC has no significant impact on stock performance. This result is inline with the prior work of Melmusi, Itona, Elfiswandi, and Kurniawan (2019).

Table 2. Random Effect Regression Result

	Coef	Std. Error	t-Stat	Prob.
C	-0.19	0.41	-0.46	0.64
EBOC	-0.25	0.20	-1.24	0.21
SBOC	0.24	0.17	1.36	0.17
QBOC	-0.08	0.20	-0.43	0.66
QA	-0.25	0.09	-2.64	0.00*
CA	-0.25	0.11	-2.22	0.02**
R2	0.20			
F Value	0.00			

Notes: * and ** indicate that a significant at 1% and 5%, EBOC = Ethnic of Board of Commissioners, SBOC = Skill of Board of Commissioners, QBOC = Qualification of Board of Commissioners, QA = Quality Audit, and CA = Company Age

Furthermore, QBOC has no relationship with stock performance. This result is in the opposite of prior work conducted by Assenga, Aly, and Hussainey (2018). They found that qualification board has positive and significant relationship with financial performance. Thus, it can be concluded that board of commissioners as measured with ethnic, skill, and qualification has no significant impact on stock performance. It indicates that the existence of board of commissioners has no significant impact in increasing stock performance of companies. This finding supports prior work of Shan and McIver (2011) who found that board of commissioners is poor in monitoring and less effective in lowering the agency problem. For the control variables, Quality Audit (QA) and Company Age (CA) have negative and significant association with stock performance.

5. CONCLUSION

Board of commissioners is key personnel in monitoring and controlling the strategy taken by board of directors. Better monitoring by board of commissioners will increase stock performance of the company. However, they have lack contribution in increasing good performance of company's stock. Thus, the result of the current study supports prior work of Shan and McIver (2011) who believe that board of commissioners is less effective in lowering the agency cost. The next paper could use other variables that can contribute to enhance better performance of company's stock such as family owners as board of commissioners members.

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